

Sales Tax and Warranties

Many retailers sell warranties or maintenance agreements along with products such as cars, computers, and home electronic equipment. This fact sheet explains how sales and use tax apply when you sell a warranty or maintenance agreement (sometimes called a "service plan") or when you make a repair covered by such an agreement.

Does sales tax apply when I sell a warranty?

It may. For sales tax purposes, warranties are divided into two basic types—mandatory warranties and optional warranties. To determine how tax applies, you first need to know the warranty type.

Mandatory warranties

A *mandatory warranty* or maintenance agreement is a contract that comes with a product you sell or that your customer must purchase. Examples include standard manufacturers' warranties that come with new vehicles, computers, electronic devices, and appliances, and auto repair shops' parts-and-labor warranties on repairs.

If your sale is taxable, the mandatory warranty is also taxable. The warranty is usually included in the price of the item sold, but you may show it as a separate charge on your invoice. If you do, that separate charge is taxable (provided the sale of the associated item is taxable).

Example: Your electronics store sells a new computer to a consumer for \$1,500. The price includes a one-year parts-and-labor warranty backed by the manufacturer. Your full \$1,500 charge is taxable.

Optional warranties

An *optional warranty* or maintenance agreement is a contract your customer may choose to purchase for an additional charge. If your customer can buy the product without buying the warranty from you, the warranty is optional. Separate charges for optional warranties are generally not taxable (exception: see optional software maintenance agreements below). Examples of optional warranties include an extended repair warranty for a computer or electronic device, an extended mileage warranty for a car, and a service plan for a refrigerator.

Example: Your car dealership sells a used car for \$10,500. You offer the customer the option to buy an extended, 18-month warranty for an additional \$500. The customer can buy the car without the warranty. If the customer buys the car and the optional warranty, tax would apply to the \$10,500 charge for the car but not to the \$500 charge for the warranty.

Optional software maintenance agreements

Beginning January 1, 2003, a separate charge for an optional software maintenance agreement is 50 percent taxable if you will provide the

Sales and Use TAX FACTS

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All printed publications are available and can be downloaded from the BOE website at <http://www.boe.ca.gov>.

Our Information Center staff is also available from 8:00 a.m. to 5:00 p.m., Monday through Friday, excluding state holidays at 800-400-7115.

(For the hearing-impaired:

— from TDD phone: 800-735-2929;

— from voice phone: 800-735-2922).

Internet: www.boe.ca.gov



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purchaser with any physical products during the term of the agreement (example: your customer will receive software updates on CD). If you will not transfer any physical products to your customer during the maintenance agreement period, charges for the agreement are not taxable (example: customers will download software updates from a website and no CDs are sent). For more information, see Regulation 1502, *Computers, Programs, and Data Processing*.

Does tax apply when I make a warranty repair?

Tax does not apply when a warranty repair includes only labor and does not require parts. But tax may apply if you furnish parts. The table below shows how tax applies to the sale or use of parts in warranty repairs that *do not* include a customer deductible or copayment. For detailed examples and information on how to apply tax when there is a customer deductible or copayment, see our publication 25, *Tax Tips for Auto Repair Garages and Service Stations*.

For warranty repairs, tax applies to charges for repair parts based on who backs the warranty—that is, the person who is a party to the warranty contract and liable for the repair.

Type of warranty	How tax applies to charges for repair parts
<i>When someone other than the repairer backs the warranty</i>	
Mandatory warranty	Parts are considered sold with the original product. Repairer's parts charge to the backer of the warranty is a nontaxable sale for resale. <i>Example:</i> Dealer repair to a new car under the manufacturer's warranty.
Optional warranty	The backer of the warranty is the consumer of parts. Tax is due on repairer's parts charges to the backer of the warranty.
<i>When only the repairer backs the warranty</i>	
Mandatory warranty	Parts are considered sold with the original product. Repairer may purchase the parts for resale.
Optional warranty	The repairer is the consumer of parts. Repairer should pay tax at time of purchase or if tax is not paid, report cost of parts on line 2 of sales and use tax return.

How do I report warranty sales on my sales and use tax return?

You must include the amounts you receive from warranty sales in "gross receipts" on line 1 of your sales and use tax return. Be sure to also list the nontaxable amounts for optional warranty sales on line 10(f), "Other" deductions.

Additional information available from our website and Information Center

Publications

- 25 Tax Tip for Auto Repair Garages and Service Stations
- 108 When is Labor Taxable?

Regulations

- 1502 Computers, Programs, and Data Processing
- 1546 Installing, Repairing, Reconditioning in General
- 1655 Returns, Defects, and Replacements

Note: The statements in this fact sheet are general and are current as of February 2006. The sales and use tax law and regulations are complex and subject to change. If there is a conflict between this publication and the law or regulations, decisions will be based on the law and regulations.